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ROLE OF TRANSNATIONAL CORPORATIONS IN SERVICES, INCLUDING TRANSNATIONAL BANKS: ROLE OF TRANSNATIONAL CORPORATIONS IN OTHER SERVICES

Impact of transnational service corporations on developing countries

Report of the Secretary-General

SUMMARY

The present report deals with the impact of transnational service corporations on host developing countries in the areas of competition and market structure, the provision of unique services and socio-cultural aspects, especially financial services. The major findings are that given the growing interest of developing countries in increasing the efficiency of producer services, transnational service corporations can play a useful role by injecting a dose of competition into the service markets of developing countries. This impact is not achieved by the mere presence of transnational corporations in host countries but often depends on government policies concerning competition.

The provision of unique services, unavailable from host-country suppliers, is one of the most important contributions transnational service corporations can make to host developing countries. Since many services are not tradeable, the only way to obtain them is from foreign service affiliates.

Finally, the social and cultural influences of transnational service corporations in host developing countries may be stronger than those of industrial corporations, especially since the service sector includes most culture- and

* E/C.10/1991/1.

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information-sensitive industries. Although some of those influences may be minimized by the actions of Governments, others may be the price to be paid for economic benefits stemming from the presence of transnational corporations. However, in many cases it is difficult to separate the influence of transnational service corporations on traditional culture and habits from the socio-cultural impact of economic development in general. The trade-offs are often difficult to determine; they depend largely on the definition of what Governments and societies consider "costs" and "benefits".

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INTRODUCTION

1. In light of the growing recognition of the importance of the service sector (and especially of producer services) for the development process, and in response to a request by the Commission on Transnational Corporations (see resolution 1988/58), the United Nations Centre on Transnational Corporations has undertaken a research programme on the relationship between developing countries and transnational corporations in services, from the perspective of developing countries. The assessment of the possible contributions of transnational service corporations to development and the potential negative effects related to their presence in host developing countries have been at the core of that programme; it has also constituted the basis for an analysis of policy implications as regards the services' foreign direct investment and the relevant negotiations within the Uruguay Round of Multilateral Trade Negotiations. Some of the issues related to the impact of transnational service corporations on host developing countries and to relevant policies were analysed in greater detail in a report presented to the Commission at its fifteenth session (E/C.10/1989/14). That report assessed the impact of foreign direct investment in services in the areas of transfer of technology, trade and business practices.

2. The present report represents a continuation of the analysis of impacts initiated in the 1989 report. It focuses on the impact of transnational service corporations on competition and market structure (sect. I), on the provision of unique services (sect. II), and on socio-cultural features of host countries (sect. III). The last section discusses policy implications arising from the analysis of those impacts. In response to the request by the Commission at its sixteenth session, special attention is given throughout the report to financial services, which are among the most important service industries.

3. The research methodology is in line with the current literature on the subject and with policy discussions regarding services (or at least groups of services such as producer services), which treat services as one sector rather than a set of unrelated activities. Furthermore, an approach which differentiates between different areas of impact makes it possible to focus on areas important to development and to distinguish between areas of potentially positive (e.g., provision of unique services) and potentially adverse (e.g., socio-cultural) impacts. It also makes it possible to analyse policy tools, such as competition or technology policy, which are used by Governments to attain economic objectives in the services sector, such as improving the availability and quality of services, and to assess the impact of transnational service corporations on the efficiency of these tools. This methodology takes into account the heterogeneity of the services sector by concentrating within each area of impact on those service industries in which the given impact is the most relevant. For instance, the impacts of transnational corporations on socio-cultural features are more strongly related to such service industries as tourism, advertising and television and radio broadcasting than, say, accounting. Competition as a tool for increasing efficiency may not be appropriate for all service industries, but there are certain industries in certain countries which may be suitable for competition, especially some producer service. Similarly, infant-industry concerns and prudential

regulations are always an important consideration in financial services, while they are not so important in tourism where environmental regulations are more crucial. There is, therefore, no one simple message emerging from an analysis of the impacts of transnational corporations, and policy conclusions often need to differentiate between individual service industries and take into account different levels of development of countries. Also, the focus of the analysis in the present report on certain issues (such as competition) does not imply that they are more important than other issues, dealt with in the previous reports. Given the wide scope of these issues, the Centre is preparing a technical study entitled Transnational Service Corporations: Impact, Policies and Options for Developing Countries (forthcoming) which not only includes a comprehensive discussion of all the important impacts of transnational service corporations on developing countries but also highlights the experiences of several developing countries in this respect.

I. COMPETITION AND MARKET STRUCTURE

4. Improving efficiency in the provision of services has not ranked high among countries' priority objectives, especially with regard to those service industries that, as government monopolies, have been heavily regulated and protected for a number of non-economic and economic reasons. It is only relatively recently that a number of developed countries have begun to give more attention to the cost of protection of their service industries and, therefore, have exposed some of them to greater domestic and/or foreign competition through deregulation, privatization and the liberalization of trade and foreign direct investment in services. In developing countries, this process has just begun, as part of greater reliance on the private sector and market forces to direct the allocation of resources.

5. Given that in 1985 services accounted for over half of the GDP of the developing countries as a group, the proportion of economic activity which lends itself to improved efficiency is very high. The evidence from input/output tables for some developing countries (e.g., Malaysia and the Philippines) suggests that a large proportion of services output - close to half - consists of intermediate input and hence affects the efficiency of other industries. 1/ Not surprisingly, therefore, there is a growing body of literature arguing that "the service sector is inextricably linked to and supportive of the manufacturing sector". 2/ Furthermore, cheaper and better services affect the competitiveness of a country's goods and services in world markets. Therefore, "increasingly, developing countries that seek to expand their exports of manufactured products have to acquire competitive inputs of services in such areas as engineering and design, software programming, communications and transportation, marketing and advertising, financing and insurance, documentation and training, and maintenance". 3/

6. Among the most important factors responsible for greater emphasis on efficiency is the increasing recognition that extensive government intervention in service industries, especially in producer services (while undertaken in response to a number of valid and important national objectives), has not always been very effective. Rather, it has often led to a sheltering of these industries from competition, which can lead to limitations in supply and a poor quality of services, creating inefficiencies throughout the economy and forcing domestic

companies to absorb the costs of those inefficiencies. As developing countries pay increasing attention to the efficiency of selected service industries, the role of Government is being reviewed and a variety of tools is being used to achieve such objectives as greater availability, improved quality and lower prices of services. The following examples are indicative:

(a) In the case of telecommunications, Governments increasingly realize that existing rules were written for yesterday's technology and are not sufficiently flexible to respond to the needs arising out of a fast-changing technological environment. In addition, domestic pressures to increase the availability and improve the quality of services are mounting. In the case of Mexico, for example, "businessmen have complained loudly in recent years that the backwardness and unreliability of the telephone system has made it difficult for them to compete in international markets and has slowed the entry of computers and other modern communications technology". 4/ In many South-East Asian countries corporate users of telecommunication services have become "frustrated by rules which prevent use in one country of what is freely available in another". 5/ Accordingly, in countries of South-East Asia and Latin America, telecommunication monopolies are being dismantled and competition is being allowed in some segments of the industry. In some countries (e.g., Argentina and Mexico), participation of transnational corporations has recently been permitted;

(b) In banking, the underlying consideration, especially in the fast-growing economies of South-East Asia and in some countries of Latin America, is that since the financial system is an important agent of economic growth, its inefficiencies retard savings mobilization, discourage investments by imposing high financial costs and occasionally place financial burdens on Governments and taxpayers. As a result, a gradual domestic liberalization is taking place, including by removing restrictions on domestic banking, easing foreign exchange controls (e.g., Thailand), 6/ while, at the same time, strengthening prudential supervision. State-owned banks are privatized (e.g., Mexico) and the establishment of new domestic banks is no longer restricted in a number of countries (e.g., Indonesia). 7/ Some countries also permit a greater role for foreign banks;

(c) Deficient services and, in addition, budgetary constraints are major factors behind changes in such service industries as transportation (especially air transportation) and public utilities. In the air transportation industry, competition is encouraged by the entry of new airlines (e.g., the Republic of Korea), 8/ or greater efficiency is sought by selling off State-owned airlines to private domestic or foreign interests;

(d) In other producer services, such as accounting, advertising or marketing, the changes in government attitudes have been less spectacular, perhaps because these services have been traditionally dominated by private firms, and direct government intervention has been less frequent.

7. Similar examples from other developing countries abound as more and more countries strive for more efficient service industries. These countries are also more inclined than in the past to permit transnational service corporations to play a role in upgrading their service industries by bringing capital, transferring

technology or providing unique services unavailable from local firms. As greater competition is increasingly being used as a tool to increase efficiency, the impact of transnational corporations on market structures and competition deserves more policy attention.

8. The scope and intensity of the impact of transnational service corporations on efficiency depends on a number of factors. The mere presence of transnational corporations in host developing countries by itself does not guarantee the benefits of increased competition. Competitive conditions are determined by market structures; these are shaped by the economic characteristics of services, government regulations and policies and the behaviour of firms, including transnational corporations. The following section focuses on major factors determining market structure and analyses the possible impact of transnational corporations on this structure and competition. The next section provides some evidence of the impact of transnational corporations on the quality and prices of services in host developing countries.

A. Market structure

9. The effects of foreign direct investment on competition are limited by the monopolistic or oligopolistic market structures that have historically existed in many service industries as a result of the economic nature of these services and/or government intervention. The scope of competition in some services is limited because they are based on expensive capital-intensive country- or region-wide networks of equipment; the establishment of multiple parallel production facilities and distribution networks by competing companies would often not make much economic sense. In most countries, Governments have, therefore, assumed responsibility for the provision of such services, usually through government-owned monopolies.

10. Examples are rail transportation, telecommunications, public utilities and air transport. The airline industry, for example, is usually monopolistic or oligopolistic. The structure of the international air transport industry is determined by international bilateral agreements based on market sharing and rate fixing. Since most countries exclude or severely limit foreign companies from having access to their domestic markets in this industry, the role of transnational corporations in increasing competition is, of necessity, limited. This situation has not changed much even in those developed countries which have decided to inject a dose of competition into air transportation through deregulation or privatization. For example, foreign direct investment has been permitted in the United States after deregulation of the country's air transportation industries, but foreign carriers are restricted to a 25 per cent ownership share of airlines. In practice, however, the Department of Transportation might block even acquisitions below that level "if it believes the foreign carrier will exert even a semblance of control". 9/ Still, the pressures of competition have, in recent years, led to a number of acquisitions of airlines by foreign competitors, both in developed and developing countries. But even in these cases, the presence of transnational corporations does not always affect the level of competition much, because the monopolistic or oligopolistic market structure usually remains in place. The role of transnational corporations in such cases is primarily to inject capital and technology rather than to create competitive market structures.

11. Financial services represent an important service industry whose market structure has been heavily influenced by government actions which have usually tended to reduce, rather than increase, the degree of competition. With the emergence and rapid spread of telematics and the resulting interpenetration of national financial markets, an increasing number of developed countries is opening up their markets to foreign competition in an effort to strengthen the competitiveness of their national financial institutions. Transnational service companies have been increasingly considered instrumental in this respect. In a viewpoint that has gained acceptance among the OECD countries, "the admittance, even of large and powerful foreign banks, will increase the number of actual and potential competitors and reduce the degree of national market concentration". 10/

12. Financial markets in developing countries are generally heavily regulated and government-controlled. Banking systems are often oligopolistic in nature, with close ownership links between banks and borrowers. In addition, public ownership of financial institutions is usually extensive. In some countries, virtually all of the formal financial service industry is in public hands; in most, over half of it is in the public sector. 11/ Many developing countries have pursued the objectives of indigenization and/or protection of their financial services on the grounds of preserving the autonomy of monetary and development policy and on the basis of infant-industry consideration. The entry of foreign banks and insurance companies is strictly controlled, and operations of foreign financial companies are usually restricted.

13. In banking, restrictions on operations can channel foreign banks, for instance, to certain kinds of operations while preserving other activities for domestic banks. Sometimes, such a policy attempts to find a balance between the host country's need for specific services unavailable locally and the protection of national financial institutions. Variations of this policy in individual developing countries (apart from those which do not allow foreign banks at all) differ mainly with regard to the scope of clients and activities allowed for foreign banks. The objective of this policy is to limit competition between local and foreign banks; as a result, financial markets in many developing countries are fragmented or segmented (see the box). A survey of eleven developing countries showed that "in all the countries of the sample, the vast majority of clients of foreign banks is made up of foreign multinational firms and major local firms. As a general rule, the foreign banks have shown very limited involvement with households, small and medium-size business, and with the rural sector". 12/ Foreign banks in Peru, Tunisia, Thailand and other countries covered by the Centre's country case studies serve mainly foreign affiliates and large domestic companies. 13/ This specific group of customers determines the types of services provided by foreign banks in developing countries: mainly corporate or wholesale banking (both foreign and domestic), trade and project finance and fee-based activities such as foreign exchange service.

Box. SEGMENTATION OF MARKETS IN BRAZIL

Brazil's financial system has been historically characterized by market segmentation imposed by regulations. However, while private local banks were able to circumvent this segmentation through the establishment of subsidiaries in all financial markets, foreign banks were not. The reason is that the Central Bank severely limited the expansion of branches by transnational banks: they could not compete for demand deposits and for payment and collection business which required the convenience of large numbers of local branches, particularly before the liberalization of branching provisions in 1984. The barriers to branching were a factor in leading foreign banks into wholesale, rather than retail, banking. Another difference between the two groups of banks was that foreign banks did very little real estate financing, as compared with domestic banks. An explanation is that the foreign banks were not permitted to hold any stake in savings and loan companies. Regulation may also have affected lending to agriculture, since commercial banks were in general required to channel 15 per cent of demand deposits into agriculture, but demand deposits were a far smaller element in liabilities for foreign than for domestic banks. The limitation on branching was one reason for the unimportance of demand deposits for transnational banks.

Legislative changes undertaken in 1988 put an end to segmentation of the Brazilian financial services by regulation. Resolution No. 1524 allows financial companies that have operated in distinct segments of the market to merge into a sole company - a multiple bank. Also several recently established foreign investment banks have been permitted to operate as multiple banks.

Source: Economic Commission for Latin America and the Caribbean, "Foreign banks in the Brazilian economy in the 1980s" (LC/L.547, 31 December 1989).

14. A segmentation of markets may also occur in the absence of major government restrictions on the activities of transnational corporations. It may result from the deliberate choices of foreign affiliates to specialize in the areas in which their more sophisticated expertise is needed and in which they have clear competitive advantages over local competitors. Another reason for specialization could be that foreign banks may not consider it profitable to lend to borrowers (small local firms, individuals) who pose both higher administrative costs and higher risks than larger clients. Also, historically transnational service corporations (including banks) have been drawn to foreign markets by their home-country clients - industrial and other service firms. Although in many cases they have expanded their clientele to include large domestic companies, the tendency to rely on the traditional home clients remains strong, especially among United States firms. 14/

15. The distinction between these two major causes of market segmentation is important for the assessment of the potential impact of transnational corporations on competition, especially in financial services. Restrictions on foreign banks in developing countries are imposed and maintained, inter alia, to protect local banks from competition from foreign companies - i.e., in order to preserve a segmentation of markets. The fear is that, in the absence of those restrictions, local institutions would be displaced by foreign firms. However, such regulation may not be necessary, if foreign firms, in any event, chose to concentrate on the areas of their own strengths. A liberalization of financial services would then result in greater specialization rather than the "crowding out" of domestic companies; the direct competitive impact of transnational corporations would then be limited to certain submarkets for more sophisticated services, and the fragmentation of markets would be maintained. (In the absence of restrictions, an indirect impact might also take place when the threat that transnational corporations might enter other submarkets stimulates more efficient behaviour by domestic companies operating in those markets in order to forestall such a move.) As the example of Chile shows, this is quite possible: after the liberalization of financial services, foreign and domestic banks have largely remained in their earlier areas of activity. 15/ Similarly, the Caribbean market is fragmented mainly because locally owned banks are not, in general, able to compete with foreign banks for lack of a large capital base and access to hard currency and new banking technology. Foreign banks compete among themselves. Therefore, the entry of the United States banks did not affect the local banks; it introduced, however, a higher degree of competition to the submarket of financial services previously dominated by British and Canadian banks. 16/ But since only few developing countries have opened their financial markets to foreign competition, it is difficult to say to what extent these examples can be generalized; it may well be that, in many cases, a "crowding-out" effect would occur.

16. In other business services such as accounting and advertising, host-country restrictions on the activities of transnational corporations are fewer and less stringent than in financial services. To the extent that a segmentation of markets takes place in these industries, it results more from the fact that firms were drawn abroad by the demand of their home-country clients and because of ownership-specific advantages over local companies rather than from host-country regulations. Still, the foreign affiliate market segment does not have to be limited to other foreign affiliates: once a firm has established itself abroad, it can take on the business of at least larger local firms in addition to that of other foreign affiliates. This is facilitated by the demand of local firms that have to compete for sales in local and export markets with transnational corporations that use modern marketing methods.

17. Business services in Peru exemplify such a dualistic market structure. Foreign service affiliates provide services to foreign and large domestic companies. Local service firms, which account for the bulk of enterprises in the respective service industries, provide services to small- and medium-sized companies. The market segment of transnational corporations is characterized by a high level of market concentration while that of local companies is highly competitive. Transnational corporations have not driven less efficient local firms out of the market, but they have made their potential access to the more demanding

and dynamic parts of the market difficult. There is also some degree of competitive interaction between the two segments of the market: the presence of foreign affiliates puts pressure on the largest local companies to reach the level of quality of foreign companies in order to maintain or increase their participation in the market. Furthermore, some local firms have attempted to emulate and even surpass transnational corporations. The end result has been better quality and a greater variety of the services offered in the market. 17/ In Zimbabwe, on the other hand, the presence of foreign service affiliates appears to be of little relevance to the intensity of competition, although some exceptions exist. 18/ In most service industries, competition is circumscribed not so much by the structure of the industries as by tight government regulation. This point is also illustrated by the insurance market of the Republic of Korea. Due to the Government's intervention, the market is oligopolistic and benefits the profitability of the established companies. The entry of a few foreign firms has not changed the market structure towards more competition but has only resulted in the redistribution of rents generated by market regulation. 19/ How difficult it is to introduce competition is also illustrated by the engineering and consultancy industry of Morocco - in this case, an industry dominated by foreign firms. Morocco attempted to reduce the extent of domination of that market by foreign firms (particularly the suppliers of equipment) by establishing a rival local company. However, the competition by foreign firms drove the local firm out of the field, restoring the power of the foreign technology suppliers. 20/

18. In conclusion, the entry of transnational service corporations into the markets of host countries does not necessarily and automatically lead to increased competition. But this can occur. Moreover, without the possibility of entry, the potential for increased competition cannot be explored. In that respect, host-country laws, policies and regulations set the preconditions for competition. At the same time, they can influence considerably the extent to which competitive market structures actually emerge. As has been observed for financial services: "artificially low interest rates, directed credits, barriers to entry, and other impediments to competition make it likely that foreign intermediaries will simply capture monopoly rents rather than promote competition and efficiency". Therefore, the establishment of a competitive environment is essential if the benefits of foreign entry are to be maximized. 21/

B. Quality and prices of services

19. The principal mechanisms through which the competitive impact of transnational service firms is exercised are lower prices and/or the higher quality of the services provided. The resulting effects may be felt in the service industries involved and, beyond them, the economy as a whole. If the market within a given service industry is significantly fragmented, however, the scope of any benefits would remain limited to the submarkets in which transnational corporations operate. This source of gains to host developing countries is inevitably speculative. But some notion of the possibilities and orders of magnitude is provided by examples concerning the costs of protection of financial services in developed countries.

20. Financial services in both developed and developing countries are a central service industry. Inefficiencies or distortions in financial markets can impose costs on the economy comparable to those of inefficiencies in intermediate goods markets (e.g., the steel market). The entry of foreign firms is one possible way of increasing the efficiency of those markets. An analysis of possible decreases in prices likely to result from the formation of a single market for financial services in the European Community - which implies the elimination or at least substantial reduction of distortions - suggests that declines in price of 10-25 per cent would occur in the poorer countries of the Community. 22/ All of those countries have income levels well above those of developing countries and probably financial services that are considerably more advanced. If these calculations are indicative, the price levels of developing countries for the more sophisticated types of financial services might fall substantially as a result of more competitive markets.

21. Evidence from service industries in host developing countries provides some insights into the various impacts of transnational corporations on the quality and prices of services. An example of the effect of inefficient loan services on prices (which in banking means the size of spreads) is given by the experience of Uruguay after 1976. There, the relaxation of entry barriers led to "... a steep rise in the number of banking houses, from 1 in 1976 to over 20 by 1980. Although they were restricted to offshore banking operations and they mainly intermediated foreign funds, a study of commercial banking loan pricing behaviour found that average price-cost margins and the variance of interest rates across banks fell. ..." 23/ On the other side, a study on financial services in the Caribbean countries reports that "... there is no evidence that where there is greater foreign participation, as for example in Jamaica and Barbados, as compared to Trinidad and Tobago that transactional costs of finance have been much less ...". 24/

22. One of the rare attempts to compare prices from different types of suppliers of auditing fees did not find any evidence that transnational firms undercut local firms by bringing down the price for the same services. The 13 largest firms (all of them transnational corporations) were found to charge higher fees in five of the eight comparisons, and lower fees in three. Presumably, they compete by offering different services. 25/ On the other hand, in the hotel industry in Morocco, the entry of foreign hotel chains has resulted in both an improvement in the quality of services and a reduction in price. The improvement stems from a change in market structure from a quasi-monopolistic position for locally owned hotels to some degree of competition as foreign firms were permitted to enter. 26/ In another instance in Mexico, foreign firms tend to charge higher prices than local companies for equivalent services. The explanation is the value of the reputation of the transnational corporations, especially in selling to other transnational corporations or to individuals from abroad - for example, in tourism and retailing. 27/

23. The presence of transnational service corporations in Peru has contributed to an improvement in the quality of consumer and producer services. This is achieved not only through the introduction of higher quality services by transnational corporations themselves but also the pressure that their presence puts on local firms to raise quality in order to compete with foreign affiliates. Local firms in

Peru usually offer the same range of services as transnational corporations, but the quality of service by foreign affiliates is higher, and an individual affiliate offers a range of services that could only be obtained from several different local firms. The availability of a range of services from one provider may itself be a quality advantage even if services of equal quality were available from a number of different providers. Two examples include transnational advertising corporations that provide a package of services which consists of market surveys, promotion, public relations and media consulting; and business service firms that provide accounting, auditing, systems development and human resources consulting.

24. The overall superiority of services by foreign affiliates is also reported for Zimbabwe. There it is attributed to the monitoring of affiliates by head offices to maintain the quality standards and hence reputation of the transnational corporations involved. Such monitoring is described specifically for affiliates in accounting, advertising and engineering. The quality advantage of transnational corporations in accounting sometimes gives local companies using those services more than merely better service: parastatals have been able to borrow internationally only if their accounts have been audited by an international firm. What the transnational corporation is providing in this case is the implicit guarantee of a certain quality that is the same around the world. It would be difficult for a local accounting firm with no international connections to offer such a guarantee credibly.

25. In conclusion, there is much evidence that the presence or entry of foreign affiliates can have a positive direct or indirect impact on the quality of services offered in host-country markets. Even if a transnational corporation does not provide a quality of service above that of the best local suppliers, it may provide a level of consistency in quality or a guarantee of a certain level of quality that local firms have difficulties in matching. In addition, it can provide some assurance of quality to foreign-owned firms operating in a host country or dealing with it but may not have the detailed knowledge of local firms. But the evidence on the impact of transnational corporations on prices is not uniform. Some examples suggest that the presence or entry of foreign firms tends to produce lower prices. There are other instances in which transnational corporations sell their services at prices higher than those of local firms for what are similar - if not identical - services. This phenomenon seems to be related to the segmentation of markets discussed in the section above.

II. PROVISION OF UNIQUE SERVICES

26. The provision of unique services is one of the most significant contributions transnational service corporations can make to host developing countries. In many of those countries, a number of needed services (e.g., to support foreign direct investment, to promote export/import operations, to undertake petroleum exploration) are not available from local suppliers. Nor can they be imported, since they may be not tradeable. The only way to obtain them is from transnational corporations established in the country. Therefore, even the developing countries with the most restrictive policies towards foreign direct investment in services recognize these needs and permit limited operations of transnational service corporations in selected industries.

27. The uniqueness of certain services typically involves some kind of "soft technologies" associated with a particular firm. The desire to acquire a unique service is sometimes the basis for investment even among developed countries. For example, in a recent joint venture between Wells Fargo of the United States and Nikko Securities of Japan, the United States partner contributed its expertise in the technique of developing and maintaining index funds for investment by pension funds, in return for the Japanese firm's resources and access to that country's pension funds. The uniqueness of the services provided by the United States investor is based on "black box technology" that combines computers with investment strategies and handles everything from digesting company financial reports with optical scanners to letting computers decide from mathematical formulas what securities to buy or sell. 28/ The United States money-management firms are unquestioned leaders in the provision of this kind of services.

28. The notion of the "uniqueness" of a service is relative and blends into the issue of the quality of services discussed earlier, since a unique service may be simply a service of a quality not available except from a single supplier or type of suppliers. Furthermore, the less developed the host-country economy, the more likely it is that there will be no local firms offering alternative services to those available from transnational corporations and, therefore, the more likely it is that the services offered by transnational corporations are unique in the country. Despite these differences in the availability of local alternatives, there are some common features to several of the unique services. They tend to be at the sophisticated end of the range of services, particularly in finance. In other cases, they involve relationships with developed-country markets that are almost impossible to attain for host-country firms unconnected to international networks.

29. Although the provision of unique services and, in particular financial services, normally involves the heavy use of computers, computers are not the basis of the technological advantage of transnational financial firms. Their advantage stems rather from their years of experience and a reputation built on superior knowledge and skill. The absence of those skills in an economy can hamper many activities outside the services sector. For example, domestic sources of long-term funding are very scarce in many developing countries, yet firms are reluctant to avail themselves of long-term foreign loans because they have no way of hedging against foreign exchange risks. Similarly, farmers in a number of major producing countries have no access to commodity futures markets; and in only few countries are there interest futures markets. Given the volatility of many developing economies, any limitations on spreading and trading risks are especially serious obstacles to efficient investment and production.

30. There are many examples showing that foreign banks have played a major role in the development of new services and markets. For example, when confronted with corporate clients in Venezuela who lacked the ability to place short-term fund in interest-bearing deposits, foreign banks pioneered a bankers' acceptance market. In Nepal, foreign banks have been instrumental in filling a market gap in the provision of term finance and appear to be prepared to take a more project-related approach to lending than domestic banks which emphasize collateralized lending. 29/ They may pioneer new consumer services too, such as credit cards. In

Thailand, foreign banks have also introduced new financial services and products to the country. Some of these consist of more flexible instruments for the local economy, including floating rate notes and interest rate hedges, and some are foreign currency hedges, which should, ideally, reduce the risks involved in both exporting and importing and thus facilitate international trade. One foreign bank responded to the fact that it is limited to a single office by installing computer equipment in clients' offices that permits the clients to perform certain operations electronically without the need for close proximity to a bank office. Another has established an on-line system to transmit information to clients via their personal computers and fax machines. Other distinctive products introduced by transnational corporations are new types of insurance, such as crop insurance for aquaculture and directors' and officers' liability insurance. In Mexico, foreign financial institutions are involved in a variety of financial operations at the more sophisticated fringes of the financial sector. In the case of insurance, reserved for Mexican companies, the foreign firms have found a role in reinsurance, because Mexican companies do not have the assets to cover all the risks involved.

31. In Zimbabwe, a number of specialties of foreign affiliates are unique in that country's service industries. Some of these reflect techniques developed by the firms themselves and are part of their advantages in operations everywhere. Others are unique only in the sense that they do not exist in local firms and reflect not so much the firm-specific advantages of transnational corporations as their large size and extensive international connections relative to those of local firms. In the case of banks, these services include the handling of countertrade and international borrowing, and in the case of accounting firms, new audit techniques. For transnational professional service firms in general, their advantage has been their greater knowledge of where to find needed expertise for complex jobs. For freight forwarding firms and for travel agents, the existence of overseas networks permitted them to supply services not available from local firms. Most of these specialties are not developed locally but are the product of a firm's experience in other countries or of their research-and-development effort, generally conducted at home.

32. An example from the Maghreb countries underscores the fact that what is a unique service in a country depends on the stage of development of the economy and the skills that have been developed locally. The management of large tourist facilities can be cited for both Morocco and Tunisia, and engineering and design services for the steel industry in Tunisia. In Algeria, the very restrictiveness of the regulations on foreign investment and the large extent of state control mean that the few foreign operations that do exist tend to provide unique services. Many of these involve services to the petroleum industry. They range from design, engineering and exploration services, as might be expected, to less obvious examples such as accounting and catering services geared to that industry.

III. SOCIO-CULTURAL FEATURES

33. Transnational corporations invariably have a social and cultural impact on the developing countries in which they operate. The impact ranges from the introduction of foreign culture (including business culture) and the erosion or destruction of traditional or native culture, through shaping the consumption patterns of host countries, to employment practices and pressures on the physical environment and social infrastructure.

34. While some of these impacts may be quite similar in the case of both transnational industrial and services firms (e.g., the construction and operation of huge hotels in remote areas and large natural resources projects), others may be stronger or even unique in the case of service industries. For example, advertising may strongly foster consumption patterns which may be considered inimical to the interests of the population as a whole. Since transnational corporations have large advertising resources, they can influence the shape and content of the media, especially radio and television. Furthermore, many services are intimately linked to such components of social and cultural life as education and entertainment. Their output consists of such cultural products as television programmes, films, magazines, books and records. In many instances, transnational corporations operating in these industries incorporate aspects of the host country's culture into their products. In others, they reproduce the cultural contents of their home country culture without much regard to social or cultural differences. It has been argued that those cultural products, by providing accounts of the contemporary world and images of a certain lifestyle, can play a pivotal role in shaping social consciousness. Problems in this area are bound to become more complex with the introduction of the new information technologies to developing countries. Transnational corporations are the world leaders in the production, distribution and utilization of information technology. Their overseas operations will increasingly require a domestic labour force trained in new managerial and technical skills and are therefore bound to affect the social structure of the developing countries in which they operate. The cultural implications of economic activity have, therefore, become especially evident in the case of foreign direct investment in some service industries, and they render more complex the policy decisions that are vital to economic modernization. 30/

35. Unlike economic impacts, for which there is often wide agreement as to whether a particular direction of change is favourable or unfavourable (a rise in real per capita income or wealth, for example, is generally considered a benefit), the judgement about social impacts is much more subjective and tends to depend on a variety of factors. Certain traditional habits or ways of thought may be attractive in some respects, but Governments may also consider them in need of adaptation in order to facilitate economic development as they perceive it. The most important socio-cultural impacts are probably subtle, and it is difficult to separate the effect of the operations of transnational corporations from those that would in any case flow from development, whether it involved foreign firms or not; at the same time, however, the role of transnational corporations is of special importance because they are, typically, the central economic actors. For example, 87 per cent of the jobs created by foreign-owned export-oriented operations in Tunisia went to women. For many traditional societies, widespread employment of

women could have a major impact on the structure of family relationships, adding to the status and independence of women relative to that of men. In fact, as with other types of foreign investment, tourism provides more job possibilities and chances for independence for women than are usually available in many traditional societies - even if the conditions under which they have to work are typically not similar to those in developed countries.

36. Often, the indigenous culture of a country is a strong attraction for tourists, but the presence of large numbers of tourists tends to distort that culture. However, education and training, often including foreign study and work, and the shift of population to cities that are important contributors to development, are likely to alter the culture in any event and to dilute its distinctiveness, and the effect of foreign tourists may only accelerate an inevitable process. In its extreme form, the dilemma is illustrated by that of distinctive groups, such as the Amish in the United States, who protect their culture by staying in the agricultural sector and denying higher education to their children.

37. Tourism, especially when uncontrolled, may invite more unfavourable responses as regards its socio-cultural effects than most other services. It has been criticized for ruining ancient monuments, encouraging prostitution and other activities considered socially harmful, and competing with more "desirable" industries for scarce resources. Those charges are often well founded, but undesirable effects may occur regardless of whether local or transnational firms operate the tourist industries.

38. A growing number of developing countries has learned how to maximize economic benefits from tourism and to limit its undesirable effects. Bermuda has been mentioned as an example of reaping the advantages of tourism, which provides 55 per cent of the GNP, 60 per cent of the foreign-exchange earnings and 70 per cent of the jobs in that country. Yet, undesirable side effects have been few, possibly because the regulation of the industry has been sensible, or because local income is relatively high. 31/ In an attempt to both protect the culture and still exploit its attractiveness to foreigners, the Indonesian authorities have decided with respect to Bali "... that tourism should be 'contained' in one resort area with active government involvement in land acquisition and the provision of utilities". 32/

39. Many developing countries have also learned to use the experience, gained mostly in Europe, to restore, modernize and adapt structures of historical and cultural value for tourist purposes, thus contributing simultaneously to the preservation and popularization of the country's cultural heritage. Further, the expansion of tourism based on cultural factors has brought new technology to such activities as the search for objects of material culture, ancient graves, structures etc., and to the process of reconstruction and protection of old structures, furniture and paintings. 33/

40. A report on new technologies in the tourism industry suggests that older forms of tourism may have required less adaptation of "the value systems, social and working habits, lifestyles ..." than, for example, modern manufacturing. On the other hand, "new technologies contribute to significant changes in the overall socio-cultural environment of tourism in the developing countries". For example, "new methods of management and organization impose strict international standards on the workplace, leaving little room for adjustment to the traditional working habits and behaviour. Large transnational corporation chains operate under unified rules and procedures specifying ... methods of work, appearance and clothing, attitudes and types of relations with visitors ...". A positive side is also perceived, however, since "the application of new technologies often coincides with various forms of employee participation, improved human relations, openness, flexibility and greater adaptability to the changing environment". 34/

41. For reasons related to the protection of the indigenous culture and to their strategic importance, severe restrictions are often placed on foreign ownership in radio and television broadcasting. That these are sensitive industries even in developed countries was made clear by the announcement of European Community recommendations on the local content of television broadcasting which urge that European television stations use for a majority of their entertainment time programmes prepared in Europe. The ostensible reason was the need "to protect Europe's cultural identity" and "to perpetuate our traditions". When such rules are imposed, it is hard to be sure how much of their rationale is the desire to protect the local culture and how much the self interest of local producers and performers preferring to operate in a protected market - much as any producers of goods might wish to do: "actors, directors and scriptwriters back quotas to stimulate European production, while broadcasters oppose limits. ... European broadcasting executives say they can usually buy the rights to an hourlong American programme for less than one-tenth what it costs to finance production of an hourlong domestic programme." The United States has viewed these proposals as nothing but protective local content provisions. 35/ Similar Canadian fears of cultural domination, or perhaps of economic competition from the United States, on the part of what one observer called "the heavily subsidized literary and little theater industry", led to an exemption of "culture industries" from the United States/Canada Free Trade Agreement. 36/

42. Views about the socio-cultural impact of transnational service firms reflect attitudes towards modernization and towards the operations of markets, as well as nationalistic sentiments. Transnational corporations, with modern styles, techniques and their competitive advantages relative to many host-country firms, are a focus for much of the criticism that would, in any event, be directed at modernizers or others who upset traditional styles of living. It is likely that transnational corporations speed up socio-cultural changes; to those who dislike them, delay may be a worthwhile objective even if change is inevitable in the long run.

43. Cultural and social issues are related to life-styles and underlying philosophies, and economic arguments - which, of course, reflect value judgements as well - often carry little weight in the debate in this area. What should be kept in mind is that many of the socio-cultural impacts that are criticized on the basis of certain criteria can be looked at as advantages on the basis of other criteria. The employment of women which erodes the traditional position of men may be an improvement in the status of women. A shift from home preparation of foods to packaged and fast foods may undermine native cuisines but free housewives and workers from drudgery. The loss of a relaxed attitude towards working hours and promptness may yield great gains in productivity and consumption levels. In the final analysis, socio-cultural impacts are difficult to evaluate, because judgements depend largely on individual and collective preferences which, of course, differ between societies, cultures and over time. For the same reason, trade-offs are often difficult to determine since they also depend on how Governments and societies define "costs" and "benefits".

CONCLUSIONS AND POLICY IMPLICATIONS

44. The main conclusion of the recent literature on the service sector (including the Centre's studies) is that it is important to discard the notion that services are unprogressive and lacking in technological content, and that little is lost by isolating them from developments in other countries. Many of these service industries have been dramatically changed by computer and communications technologies, and these changes have affected even such relatively labour-intensive industries as tourism and banking, which developing countries had tended to think could be, with little risk, restricted to local firms and nationals. The result has often been stagnation and inefficiency in a country's service sector and the slowing of progress in what was thought of as the more important goods-producing sector.

45. Many developing countries have become aware of the adverse effects for their economies which can result from the backwardness of the service sector, especially producer services, and have responded by revising their policy objectives in selected producer services towards the promotion of greater availability and improved quality of services and by moving tentatively towards lifting restrictions on transnational corporations. That change in policy has probably been accelerated by pressures from developed countries to open their service-industry markets to their firms, but the direction of changes in policy has been the same even in countries and industries in which external pressures have not been important.

46. As a result, developing countries have become much less hostile to transnational service corporations in the past few years. However, efforts are still common to confine those firms to selected industries and, within them, to specific market segments - e.g., serving other transnational corporations or export markets. The unintended result can be to make indigenous firms in other industries less competitive relative to rivaling foreign affiliates and relative to firms in other countries, because the local firms are denied access to the best service products. This is particularly important because most of the effects resulting from foreign direct investment in services in host countries are of an indirect

nature, arising from their linkages with other producers and industries and their customers. Particularly important are links between business and financial services and public utilities, on the one hand, and the manufacturing sector as a purchaser of services, on the other. Even the services of hotels and restaurants, generally thought of as consumer services, are to a considerable extent business services as well. On the whole, since the effects of foreign direct investment in these services are mainly to introduce new technology and new services, increase competition in service markets and reduce the prices of services, the impacts on other sectors are in general favourable. They tend to increase the productivity of other industries and reduce their costs, to the benefit of local consumers, purchasers of intermediate products and exports in a wide range of industries.

47. One of the fears of developing countries with respect to transnational corporations, and particularly those in industries not primarily geared to foreign markets (which include many service industries), is that they will drive out domestic firms and monopolize local markets, capturing rents that would otherwise accrue to local firms or consumers. In fact, much of the evidence on the aftermath of the entry by foreign firms points to an increase in the degree of competition. That is partly because they enter situations in which local monopolies had previously operated and in which any entry would increase the degree of competition; but it may also be that host-country Governments are more alert to the dangers of a foreign-controlled monopoly than to those of a domestic one. Where transnational corporations have made very high profits, the source seems usually to have been an insufficient amount of competition or host-country policies that discouraged active competition. One widely used variation of policies restricting competition bars foreign firms from certain activities while allowing them to undertake others. What host developing countries hope to gain from this kind of policy is the provision of unique services that are not available from local firms, along with the protection of domestic firms from possible displacements from the market. Such a policy is often based on infant-industry considerations. However, if it is carried too far in its restrictiveness, it may have the consequence of preventing host-country firms from submitting themselves to the rigours of international competition. While the danger of displacement of local companies by foreign competitors should not be dismissed, there has not yet been much evidence indicating that considerable displacement has to occur as a result of the liberalization of markets. Another outcome may well be increased specialization between local and foreign companies.

48. Any degree of entry allowed to transnational service corporations is likely to lead to some acquisition of new technology by host-country firms and individuals and to improved service industry efficiency through the injection of a dose of competition into protected service markets. The latter impact is, however, not obtained by the mere presence of transnational corporations; rather, it depends also on governmental policies concerning competition. Transnational corporations, like other large firms, are adept at taking advantage of monopolistic positions, including those facilitated by host-country regulations, which are an important factor determining the distribution of benefits associated with foreign affiliates between host countries and transnational corporations. Permitted to operate in protected host-country markets, transnational corporations are likely to capture monopoly rents rather than promote competition and efficiency. Therefore, an

active encouragement of entry into the market by local firms to make industries as competitive as possible is as important as liberalizing entry for foreign investors in terms of possible gains for the host country. In financial services, the establishment of a competitive environment would in many cases require the deregulation and restructuring of domestic financial institutions. At the same time, care would have to be taken that this process does not conflict with basic prudential requirements which, in fact, may have to be strengthened in many cases. 37/

49. Another issue related to competition and efficiency concerns actions by private corporations to restrict competition. Transnational corporations have been criticized for applying restrictive business practices in their affiliate operations, and this is certainly the case if their behaviour is compared with a theoretical norm of perfect competition. But the very existence of transnational corporations in an industry shows that the perfect competition model does not apply fully. Departures from that model are at least partly the consequence of the existence of firm-specific assets, such as technological skills. By their nature, these are often not exploited through trade among firms, because of the uncertainty about their value and because they are often difficult to define and to measure. Since a transnational corporation is defined by virtue of its control of these assets abroad, the parent firm will control the behaviour of its affiliates in at least some respects, rather than leave them to operate entirely autonomously. Total affiliate autonomy would, de facto, dissolve a transnational corporation and turn it into a simple holding company or portfolio investor. There would be no reason for a firm with a specific technology to exploit it through investments.

50. While host-country Governments may be concerned by the restrictions or rules imposed by the headquarters of transnational corporations, the acceptance of some of those rules may be the price for acquiring the use of the transnational corporations' technology. But this is not meant to imply that every restriction which a transnational corporation may choose to impose should be accepted; some of the restrictions have proven to be dispensable or negotiable. But completely forbidding a transnational corporation to control its affiliate may cost a host country access to the firm's technology. In addition to negotiations, another way of limiting the possibility of the use of restrictive business practices by transnational corporations (as well as local companies) is to adopt clear-cut competition policies and establish an enforcement mechanism which monitors them. Since the encouragement of competition does not rank high among their policy tools towards the service sector, many developing countries do not have such policies.

51. Some of the restrictions on transnational service enterprises imposed by developing countries are justified on the grounds of protecting traditional indigenous culture. There is no obvious economic measure of the value of the preservation of traditions, and some may even consider aspects of such traditions to have negative economic and social consequences. The influence of transnational service enterprises on traditional cultures and habits is very difficult to separate from the socio-cultural influence of economic development in general. An example of a clash of judgements as to the desirability of consequences concerns the extensive employment of women in assembly plants and service affiliates of transnational firms. The greater independence for women brought about by

employment outside the home may be thought to be desirable or not, but it clearly undermines traditional family arrangements in many societies. Some of the obvious undesirable socio-cultural effects may be minimized by the actions of Governments (e.g., the promotion of tourism based on cultural heritage, environmental regulations) or by agreements negotiated between Governments and transnational corporations which provide for compensation for those adversely affected by large projects (e.g., hotel construction) or by promoting sensitivity to the local culture. Others will remain as a price to be paid by the society for the achievement of economic objectives and benefits related to the activities of foreign affiliates.

52. All this points to the need, emphasized repeatedly by the Centre, for countries to review their existing policy framework in the service sector (see, e.g., E/C.10/1989/14). Particular attention needs to be given to producer services and the role that transnational service corporations can play in transferring technology, providing unique services, increasing the quality and decreasing the prices of services, and stimulating competition. As developing countries review their policies in the light of their objectives and changing national and global conditions, one of the important considerations in the process relates to the economic costs of protecting inefficient domestic service industries and ways and means of enhancing the competitiveness of those industries, including through greater competition among domestic and foreign firms. Another important consideration relates to ways and means of minimizing the possible adverse socio-cultural effects of the activities of transnational service corporations.

53. Apart from continuing to assist developing countries in the area of services through policy-oriented research, the Centre may also be able to draw on its considerable knowledge gained in the course of its technical co-operation in various service industries in order to generalize and disseminate its experience and advice given to individual countries.

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